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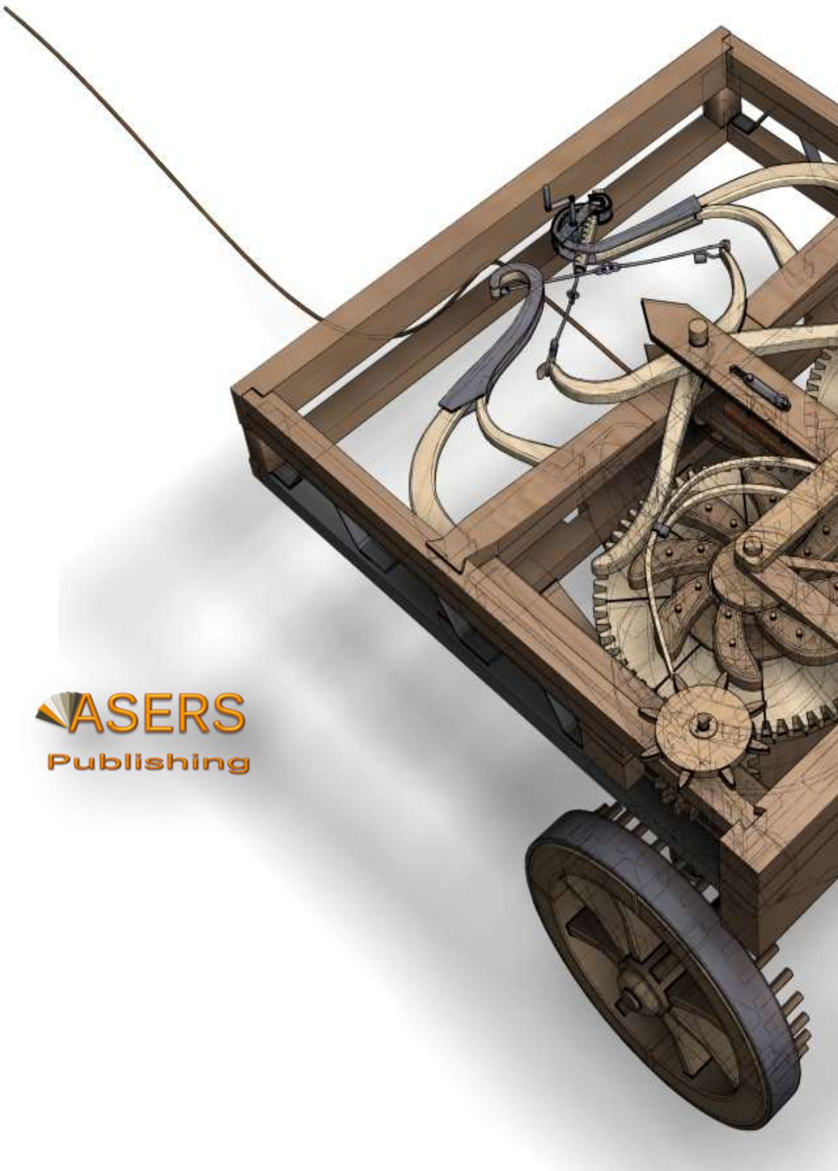

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Journal of Environmental Management and Tourism

Journal of Environmental Management and Tourism is an interdisciplinary research journal, aimed to publish articles and original research papers that should contribute to the development of both experimental and theoretical nature in the field of Environmental Management and Tourism Sciences.

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Banking Risks and Lending to Tourism and Hotel Businesses amid the COVID-19 Pandemic

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Abstract

The purpose of this paper is to explore the risks associated with lending to tourism and hospitality businesses in the context of COVID-19 restrictions. The author proposes a scoring methodology to assess the quantitative and qualitative factors of borrowers' credit standing based on industry-related risks and the quantification of potential loss given default. The analysis of credit standing draws on actual figures from financial statements of the ten biggest tour operators present in the Russian and Kazakh tourism markets, as well as a survey of experts specialising in bank lending.

The findings confirm the proposed hypothesis of a negative impact of the pandemic on the financial condition and credit standing of tourism and hospitality businesses and an increase of banks' credit risks. The trends of lending to tourism and hotel businesses have indicated a contraction of credit supply as a result of the low credit standing of borrowers. An industry analysis shows that losses from the materialisation of credit risks in the group of tourism businesses could be significant for banks. The author concludes that to maintain financial stability and the level of credit in the industry, the state should continue to support the sector, including the provision of soft loans to help finance some items of expenses.

Keywords: credit risk; credit standing; lending; COVID-19; default; tourism; hotel business.

JEL Classification: E50; Z30; E30; H12.

Introduction

The COVID-19 pandemic caused a global macroeconomic shock threatening to push the global economy into a recession of an uncertain scale and length. Tourism is one of the hardest-hit sectors. According to the UNWTO (n.d.), international tourist arrivals declined 73% from the previous year, resulting in a loss of $4.5 trillion (World Travel & Tourism Council n.d.) and about 62 million jobs. The GDP share of tourism fell by 49.1% in 2020, resulting in a loss of more than $2.5 trillion for the global GDP.

According to the IATA (2021), the total passenger number in 2020 was down by 68.9% versus 2019. As a result of the COVID-19, airline revenues fell 55.6% in 2020 to $372 billion versus 2019's $838 billion.

The pandemic also significantly hurt the hotel industry. *E.g*., the biggest international hotel chain operator Marriott International with a portfolio of 7,600 properties spanning 133 countries reported a 60% decline in RevPAR (revenue per available room), while the company's hotel occupancy rate stood at only 35.5% (Marriott International 2020). As a result, company revenues fell by half, leading to a loss in 2020 (-$466 million).

Hyatt Hotels Corporation's RevPAR declined by 65.4% in 2020 compared to 2019 (Hyatt Hotels Corporation 2020), with a full-year net loss of $703 million. The biggest hotel corporation Hilton reported a net loss on discontinued operations of $715 million in 2020 (Macroaxis 2021).

The pandemic caused a sharp reduction in investment in tourism. After a very strong investment cycle in tourism in 2018 and 2019, a rapid fall occurred, and the number of investment projects in the accommodation sector fell by 68% in 2020 compared to the previous year (FDi, UNWTO 2021). The main destination for foreign direct investment (FDI) by the volume of capital is the Asia-Pacific region. Despite a 79% drop compared to the previous year, the region attracted FDI in tourism to the tune of $5 billion.

The industry being capital-intensive, tourism projects often require significant investment into land, construction, equipment, furniture, marketing, transport and working capital (Gasparian *et al.* 2021, 479; Shishov *et al.* 2018, 1156; Vinichenko *et al.* 2021, 17). As the pandemic drags on, tourism and hotel businesses face an increasing financial deficit, as operational cash flows drop down or cease. The demand for bank loans, including on existing credit facilities opened to the industry, has grown significantly.

Meanwhile, access to capital and loans for tourism and hotel businesses is limited in developing countries with underdeveloped capital markets and high political risks (Shubtsova *et al.* 2020, 1427; Zhilenko *et al.* 2021, 1236).

Therefore, the banking system faces a double challenge to maintain credit flow for the tourism industry amid declining tourist flows and to manage elevated risks (Karmanov *et al.* 2020, 346; Shayakhmetova *et al.* 2020, 489). Given the uncertainty of further developments around COVID-19, credit risks are growing sharply and, consequently, capital and liquidity requirements on the financial systems get tougher.

To support the tourism sector, governments implement various political solutions. Many national governments have adopted measures to relieve economic shocks and provided support to the hotel and tourism sectors, including soft loans and guarantees.

However, many developing countries in the Asia-Pacific region and particularly small island states, where the overall tourism contribution as a share of GDP exceeds 50% (*e.g.,* Macau, Maldives, Vanuatu) and economies of Central Asia haunted by structural problems fail to maintain the required level of support to the industry.

This research hypothesizes that COVID-19 has had a negative impact on the credit standing and increasing credit risk associated with lending to the tourism and hotel sectors.

1. Literature Review

Literature review suggests that risk is an inevitable component of banking (Buyl *et al.* 2019, 1372). Over the last decade, bank credit ratings were threatened by major developments, such as the financial crisis (Beyer *et al.* 2017, 45) and an increase in nonperforming loans (Baudino *et al.* 2018).

Carr emphasises the relevance of credit risks by pointing out that maintaining stable cash flows is vital for business survival but in the increasingly complicated environment, managing cash flows from debtors becomes more difficult (Dao *et al.* 2020, 44). The heightened relevance of credit risk management in the banking sector is the subject of multiple studies. As can be seen from the findings of empirical studies of A. Tasintsadze, Glonti V (2019), J. Khorassani (2012), E. Al-shakrchy (2017), S. Mall (2018), O. Lavrushin, N. Sokolinskaya (2020), credit risk is one of the most important risks for banks and it occurs when borrowers and counterparties default on their contractual obligations.

In the past year, researchers across the world have focused on the impact of COVID-19 on different sectors of the economy. The findings of P. Ozili (2021), S. Roy (2020) and so on indicate that pandemic-related restrictions resulted in declining economic activity levels nearly across the board. Many researchers specifically point at tourism and the hotel sector as industries considerably suffering in the wake of COVID-19 and brought to a critical condition (Baba *et al.* 2020, 271; Hall *et al.* 2020, 577; Hoque *et al.* 2020, 52; Jones and Comfort 2020a, 3037; Nhamo *et al.* 2020, 183).

Based on the analysis of the impact of previous global crises on banking systems, many researchers predict significant negative influence of the current crisis caused by COVID-19 on commercial banks (Boru 2020, 53; Buehler *et al.* 2020). Their findings (Gennaro and Nitlispah 2021, 419; Sansa and Hasan 2020, 29; Wahyuni *et al.* 2021, 104) suggest that the pandemic has driven many lending institutions to cut credit supply due to expectations of growth of bad debts. Borrowers' deteriorating credit standing caused negative adjustments in credit ratings and growing default risks (Naumenkova *et al.* 2021, 104).

Meanwhile, where it concerns the credit risk problem and the deteriorating credit standing of businesses in the hardest-hit sectors during the COVID-19 pandemic, such as tourism and hotels, the topic is still under-researched.

2. Methods

To collect evidence on the trends of lending to businesses in the tourism and hotel sectors and to map banking risks, we used a survey of competent experts on bank lending, specifically those working with lending institutions from Kazakhstan and Russia. The survey was conducted by sending out online questionnaires to a sample of respondents. Overall, 110 invitations to take part in the survey were sent out. 67 people eventually responded and took part in the survey.

Credit risk analysis was conducted by the method of financial coefficients and the scoring method. 10 biggest tour operators operating in Russia and the Republic of Kazakhstan were selected for analysis.

Credit risk assessments were conducted in two stages.

The first stage involved calculating borrowers' credit standing coefficients.

The following formula was used:

$$Icr = I_{ir} + I_{fr}$$

where Rcr_i is the credit standing coefficient for borrower i;

I_{ir} is the integral industry risk score;

I_{fr} is the integral financial risk score.

Integral risk scores are calculated by adding up scores of quantitative and qualitative factors of credit standing weighted by significance (Table 1).

Table 1. Significance of credit risk factors

Risk	Factors	Weight by significance, %
Industry risk	***Total***	***30%***
	Rate of overdue debt for the industry	10%
	Resilience of the industry to external shocks	10%
	Barriers to entry	10%
Financial risk	***Total***	***70%***
	Equity to Total Assets	10%
	Net Working Capital to Current Assets ratio	10%
	Financial Stability Ratio	10%
	Cash Ratio	5%
	Quick Ratio	5%
	Current Liquidity Ratio	10%
	Return on Equity (ROE)	5%
	Return on Assets (ROA)	10%
	Net Return on Sales	5%

The evidence base for assessing business risks is data of the Bank of Russia (2021) and the National Bank of the Republic of Kazakhstan, as well as the results of the survey conducted among experts of tourism and hotel businesses.

Borrowers' financial risk assessments are based on calculations of ratios characterising their financial standing in terms of financial stability, liquidity, solvency and efficiency of operations.

Industry risk calculations are based on appraisals of tourism industry trends according to the following indicators (Table 2):

Table 2. Industry risk scale

Factors	Scores				
	1	0,5	0	-0.5	-1
Annual average of overdue debt for the industry	Below 3%	3% to 7%	7% to 11%	11% to 15%	Above 15%
Resilience to external shocks	High	Above average	Average	Below average	Low
Barriers to entry	Very high	High	Average	Low	Absent

The evidence base for this analysis is developed from the data of accounting statements of tour operators operating in Russia and the Republic of Kazakhstan. The main information sources include the State Information Register of Accounting (Financial) Statements of Enterprises of the RF (Federal Tax Service of the Russian Federation n.d.), the online service for public services and information eGov of the Republic of Kazakhstan (Ehlektronnoe pravitelstvo Respubliki Kazakhstan n.d.), the Kompra service for verification of counterparties from the Republic of Kazakhstan (Kompra n.d.).

The method of coefficients is used to assess the borrowers' financial standing, with a score assigned to each coefficient within the range of -1 to 1 according to Table 3.

Table 3. Scores for coefficients of borrowers' financial standing

Criteria	-1	0	1
K1 Equity to Total Assets	МЕНЕЕ BELOW 0.4	0.4-0.5	above 0.5
K2 Net Working Capital to Current Assets Ratio	below 0.1	0.1-0.4	above 0.4
K3 Financial Stability Ratio	below 0.6	0.6-0.8	above 0.8
K4 Cash Ratio	below 0.1	0.1-0.25	above 0.25
K5 Quick Ratio	below 0.4	0.4-0.8	above 0.8
K6 Current Liquidity Ratio	below 0.8	0.8-1.2	above 1.2
K7 Return on Equity (ROE)	below 0	0%-6%	above 6%
K8 Return on Assets (ROA)	below 0	0%-0.5%	above 0.5
K9 Net Return On Sales	below 0	0%-2.9%	above 2.9%

Based on the calculations of credit standing scores, borrowers' credit ratings are determined according to the following scale (Table 4).

Table 4. Borrowers' credit rating scale

Credit quality category	Description of credit rating and financial reliability	Score	Probability of default (PD) (Expert Rating Agency 2021)
AAA	Highest	0.85-1	0.00%
AA	High	0.64-0.85	0.28%
A	Higher medium	0.43-0.64	0.94%
BBB	Moderate	0.22-0.43	2%
BB	Medium	0.01-0.22	3.66%
B	Lower medium	-0.2-0.01	7.96%
CCC	Low	-0.41-(-0.2)	21.54%
CC	Very low	-0.62-(-0.41)	40%
C	Default state	below -0.62	40%-100%

The second stage involved the calculation of potential losses in case of credit risk materialisation at tourism businesses according to the following formula:

$EL = PD * LGD * EAD$,

where EL is the amount of estimated loss, USD

PD is the probability of default according to the credit quality category

LGD is the level of loss given default. The calculation is based on the coefficient of 0.45 (for unsubordinated unsecured loans)

EAD is the outstanding loan balance exposed to default risk.

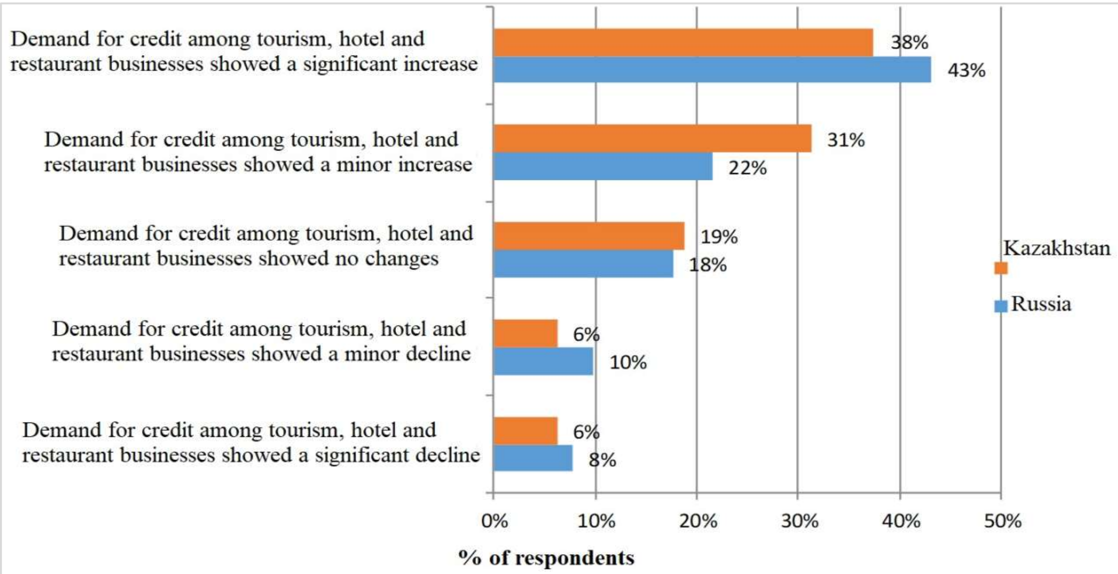
3. Results

As a result of restrictions imposed in the wake of the COVID-19 pandemic, the main financial indicators of tourism and hotel businesses went down considerably.

E.g., according to TestFirm.ru (2020a), the average return on sales for the industry in the Russian Federation fell to 2.9% in 2020 compared to 10.5% in 2019, while net profit margin dropped to 0.6% from 4.9%. The decline in the interest coverage ratio to 1.11 from 5.57 (TestFirm.ru 2020b) reflects the deteriorating capability of tourism businesses to service their debts. Similar trends are observed in the financial indicators in the hotel sector: the average return on sales declined to 3.3% from 7.1%, while net profit margin dropped to 1.3% from 3.1%, the interest coverage ratio contracted to 0.49 from 2.04.

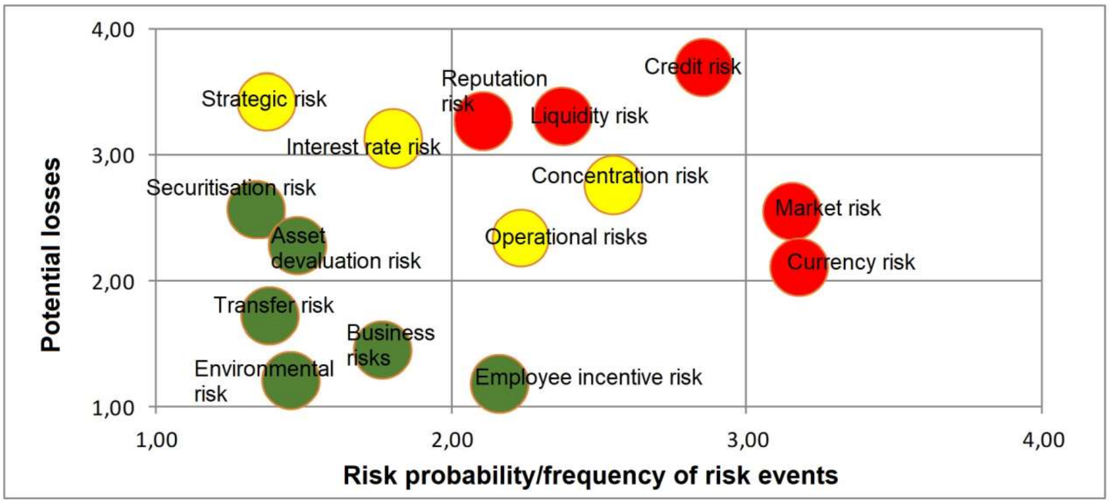
The findings of the expert survey indicate that tourism and hotel businesses have larger borrowing requirements to finance overhead expenses unrelated to the volume of services provided (rent, payroll costs, etc.) (Figure 1).

Figure 1. Distribution of respondents' statements on how demand for credit has changed among tourism, hotel and restaurant businesses



According to the results of risk mapping, the most serious risks are deemed to be credit, reputation, market, currency and liquidity risks (Figure 2).

Figure 2. Map of banking risks

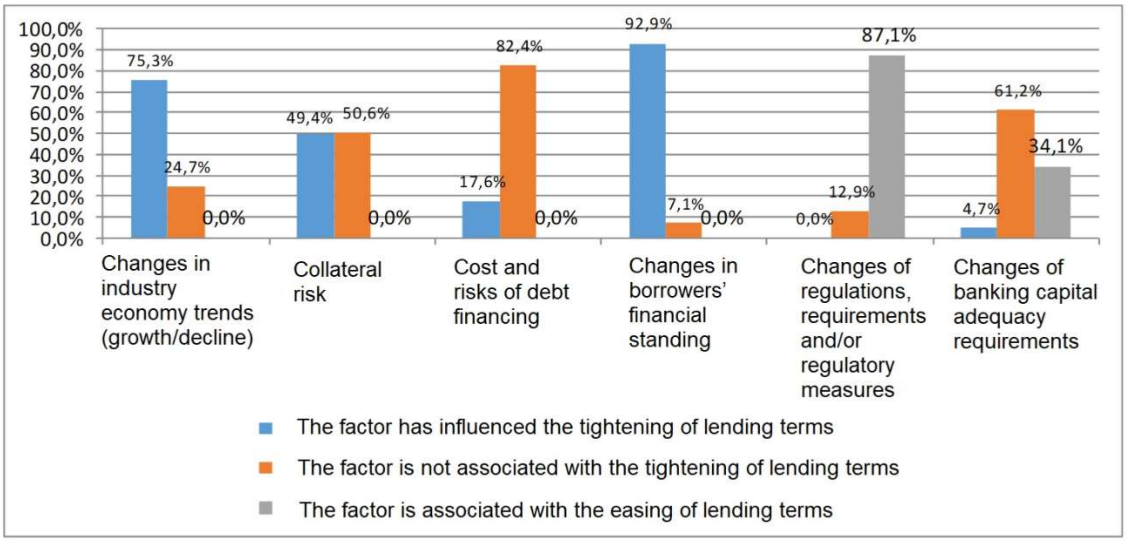


Based on both factors of significance, the highest level is assigned to credit risks, specifically, risks of losses for banks as a result of non-performance under loan agreements due to the deterioration of the borrower's financial standing and/or defaults.

Given this high significance of credit risks, the willingness of lending institutions in the analysed countries to extend credit to tourism, hotel and restaurant businesses has declined and the terms of loans for borrowers from the tourism and hotel sector were tightened.

Figure 3 renders factors according to their degree of impact on the tightening of lending terms for tourism businesses.

Figure 3. Factors driving the tightening of lending terms for tourism, hotel and restaurant businesses, % of respondents



The findings of this survey suggest that the tightening of lending terms for tourism, hotel and restaurant businesses was affected by the downturn in the tourism economy, which caused a deterioration of the credit standing of most borrowers.

4. Results of Credit Risk Calculations

The results of the above research suggest that in 2020, overdue debt levels on bank loans extended to tourism and hotel businesses equaled 4.6% in Russia and 6.8% in Kazakhstan. Accordingly, the score of overdue debt on bank loans extended to tourism and hotel businesses is 0.5.

The results of scoring industry risks for tourism and hotel businesses by external factors are laid out in Table 5.

Table 5. Industry risk scoring results

	Score					Total
	1	0.5	0	-0.5	-1	
Industry resilience to external factors						
Number of respondents	1	7	12	14	33	67
Average score	1	3.5	0	-7	-33	**-0.53**
Barriers to entry						
Number of respondents	0	3	10	35	19	67
Average score	0	1.5	0	-17.5	-19	**-0.52**
Level of overdue debt						
For Russia		4.6%				**0.5**
For the Republic of Kazakhstan		6.8%				**0.5**

The resulting financial risk scores for 10 leading tour operators of Russia and Kazakhstan are laid out in Table 6.

As can be seen from Table 7, most of the analysed businesses fell within the low bracket by credit standing and financial standing at the end of 2020. Meanwhile, three out of the ten discussed tour operators have very low credit ratings (CC). The probability of default for these borrowers is rather high and banks face rather high credit risks in tourism.

Estimates of potential losses given default for such borrowers are laid out in Table 8.

Accordingly, in case of default and credit risk materialisation, banks' losses associated with lending to tourism businesses can be significant and exceed $48.9 million.

Table 6. Financial risk scores

Indicator	TIU		Tez Tour		AnexTour		Coral Travel	
	Value	score	Value	score	Value	score	Value	score
K1	-0.05	-1	0.17	-1	-0.02	-1	0.01	-1
K2	0.04	-1	0.27	0	-0.02	-1	0.01	-1
K3	-0.04	-1	0.17	-1	-0.02	-1	0.01	-1
K4	0.01	-1	0.08	-1	0.01	-1	0.01	-1
K5	0.87	1	1.11	1	0.97	1	1.07	1
K6	0.87	0	1.11	0	0.97	0	1.07	0
K7	-12.4%	-1	-17.6%	-1	277%	1	2.40%	1
K8	-19.72%	-1	-4.8%	-1	-4.24%	-1	0.02%	0
K9	-52.20%	-1	-179.8%	-1	-94.38%	-1	0.40%	0

Indicator	SUNMAR		Pegas Touristik		ICS Travel Group		Biblio Globus	
	Value	score	Value	score	Value	score	Value	score
K1	0.01	-1	0.49	0	0.63	1	-0.26	-1
K2	0.01	-1	0.72	1	0.63	1	0.74	1
K3	0.01	-1	0.49	-1	0.63	0	-0.26	-1
K4	0.02	-1	0.6	1	2.67	1	0.13	0
K5	0.69	0	1.83	1	2.68	1	0.78	0
K6	0.69	-1	1.84	1	2.68	1	0.79	0
K7	9.30%	1	-29.7%	-1	0.0%	0	-181.2%	-1
K8	0.08%	0	-16.7%	-1	0.0%	0	15.3%	1
K9	5.18%	1	-83.7%	-1	29.2%	1	14.0%	1

Indicator	NTK Intourist		Mouzenidis	
	Value	score	Value	score
K1	-0.82	-1	-0.01	-1
K2	0.15	0	0.99	1
K3	-0.81	-1	-0.01	-1
K4	0.02	-1	0.02	-1
K5	0.53	0	1.01	1
K6	0.53	-1	1.01	0
K7	41.2%	1	-496.3%	-1
K8	-42.9%	-1	-4.4%	-1
K9	-179.8%	-1	-68.8%	-1

The resulting integral risk scores for the selected tour operators are laid out in Table 7.

Table 7. Results of credit rating calculations for selected tour operators

Tour operators	I_{ir}	I_{fr}	Icr	Credit rating
TIU	-0.005	-0.5	-0.51	CC
Tez Tour	-0.005	-0.4	-0.41	CCC
AnexTour	-0.005	-0.4	-0.41	CCC
Coral Travel	-0.005	-0.25	-0.26	CCC
SUNMAR	-0.005	-0.35	-0.36	CCC
Pegas Touristik	-0.005	0	-0.01	B
ICS Travel Group	-0.005	0.45	0.45	CC
Biblio Globus	-0.005	0	-0.01	B
NTK Intourist	-0.005	-0.45	-0.46	CC
Mouzenidis	-0.005	-0.3	-0.31	CCC

Table 8. Estimates of potential losses given default in tourism

Tour operators	PD	LGD	EAD	**EL**
TIU	40%	45.00%	236,223.44	42,520.22
Tez Tour	21.54%	45.00%	0.00	0.00
AnexTour	21.54%	45.00%	289.26	28.04
Coral Travel	21.54%	45.00%	1,063.50	103.09
SUNMAR	21.54%	45.00%	63,543.36	6,159.26
Pegas Touristik	7.96%	45.00%	0.00	0.00
ICS Travel Group	40%	45.00%	0.00	0.00
Biblio Globus	7.96%	45.00%	0.00	0.00
NTK Intourist	40%	45.00%	693.36	124.80
Mouzenidis	21.54%	45.00%	54.85	5.32
Total losses, thousand USD				48,940.72

5. Discussion

The above results confirm the conclusions of A. Tasintsadze and V. Glonti concerning the high significance and priority of credit risks for banks, investors and corporations in the wake of all sorts of consequences of the COVID-19 pandemic. Moreover, the results expand the earlier research by Jones P. Comfort D (2020a, 2020b) on financial instability and uncertainty of development in the sector.

We support the view of Gursoy D., Chi C.G. (2020) that the economic fallout of COVID-19 has been highly disruptive for tourism and the hotel industry, and their further recovery would depend significantly on the effectiveness of political measures and state support of businesses in the sector.

While the Russian Government and the Government of Kazakhstan have adopted a set of measures to help the tourism and hotel sectors absorb the shock, it is necessary to make sure that going further, coordinated measures are taken to help the industry recover. *E.g.*, the Russian Federation has implemented an unprecedented programme to support tour operators, helping companies to not only bring down their liabilities owed to tourists but also to prevent defaults.

In our view, the most effective measures of state support that helped to avoid rolling defaults in the tourism and hotel industry included the following:

- Zero-interest loans to fund payroll expenses (0% for the first six months and 4% in the following six months);
- Moratorium on bankruptcies for six months;
- Moratorium on tax sanctions and tax, customs and on-site inspections;
- Tax holidays for 12 months;
- Subsidies for renewing operations;
- Cardinal cut of tour operators' contributions payable to the reserve fund of the Association "TourAssist" to 1 ruble;
- Grants to fund payroll outlays, urgent expenses and utility payments for SMEs engaged in the tourism and hotel sectors.
- Lending and refinancing for sole traders and small businesses at the soft rate of 8.5%;

The Republic of Kazakhstan adopted support measures for all SMEs without any specification of measures for tourism and hotels:

- corporate property tax exemption;
- deferrals of taxes and social security contributions;
- six-month moratorium on refunds on suspended travel during the period of quarantine;
- soft loan programme for small and medium businesses;
- easing on fines for missed payments;
- deferrals for 90 calendar days on loan agreements.

Debate is still on as to the possibility of extension of applicable soft loan programmes for tourism and hotel businesses.

Despite mass soft loan programmes in 2020, the level of credit in tourism remains low and follows a downward trend. The business resource base in the industry grows faster than the volume of credit. Given the moderate rate of lending to tourism and hotel businesses amid the increasing cost of funding, one might expect that Kazakh and Russian banks will not be able to maintain the net interest margin at the level of 2020.

In the absence of mechanisms for the government to fairly compensate banks for their shortfall in revenues, interest rates on soft loans to tourism and hotel businesses do not offset the scope of losses on materialisation of credit risks and fail to provide the necessary margin levels. Meanwhile, revenues at many tourism and hotel businesses yet remain below the 2019 levels and are insufficient to serve loans at market rates banks offer to high-risk industries.

Therefore, we agree with the view of Expert RA experts that mid-term growth in lending to tourism and hotel businesses will be driven by government support programmes (Kozhekina *et al.* 2021).

We agree with the conclusion of the experts of McKinsey & Company that it will take several years for tourism to return to 2019 levels, which means that the way tourism is financed needs to change (Margaux *et al.* 2020). Such mechanisms include the creation of revenue-pooling structures among hotels competing for the same segment and state investment funds for businesses associated with tourism.

Conclusion

The findings indicate that throughout restrictions imposed in the wake of the coronavirus infection, credit risks associated with lending to borrowers from the tourism and hotel industry have strongly increased and become significant risks for banks, which completely confirms the hypothesis put forward in this research.

The results of this research allow us to draw the following conclusions:

- The contracting credit supply for tourism and hotel businesses reflects the worsening solvency and financial stability conditions of borrowers due to a slowdown or discontinuation of core operations in the wake of COVID-19.
- An analysis of the ten biggest tour operators from Russia and Kazakhstan indicated low credit standing and financial stability for most of them.
- Credit risks have the highest level of significance for banks due to losses associated with defaults on loan agreements.
- In case of default and credit risk materialisation with only the select 10 tour operators, total losses can be approximately $48.9 million. We suppose that given mass lending to tourism businesses, banks might face significant losses in case of credit risk materialisation.

State support measures implemented by the Russian Government and the Government of Kazakhstan helped to avoid rolling bankruptcies in the tourism and hotel industries. Meanwhile, such measures as soft loans to fund some types of expenses, e. g., payroll, should be extended as the industry has not yet recovered from the shock and it will take some time for businesses to restore their credit standing.

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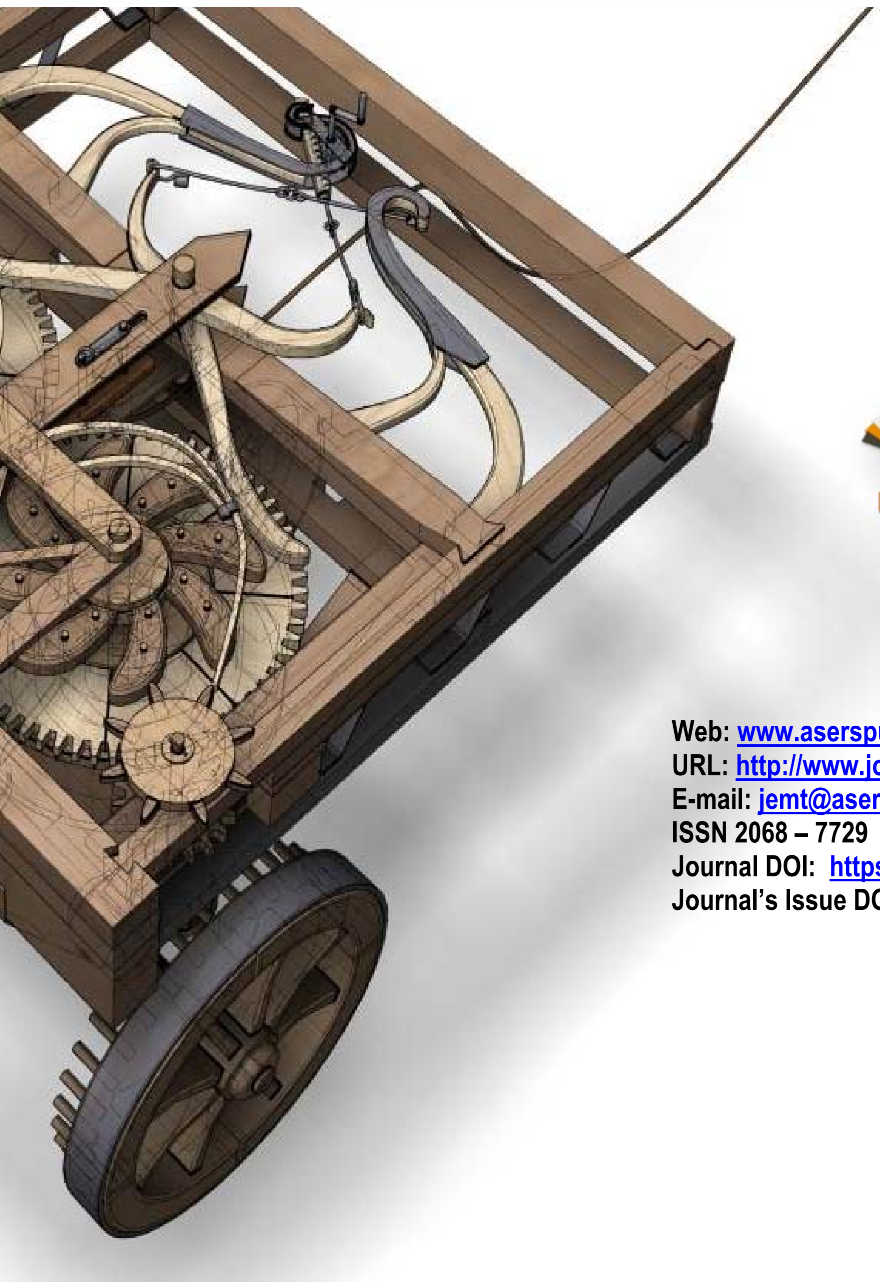

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